AGRICULTURAL POLICIES IN OECD COUNTRIES: A POSITIVE REFORM AGENDA

Introduction

Governments have long intervened in domestic and international markets for agricultural and food products. The apparent rationale for doing so has changed over time, but the nature of the policies in place across the OECD-area has responded slowly. The result is a complex web of policies, generally aimed at a diversity of sometimes conflicting objectives, and an assortment of both intended and unintended effects.

Why have OECD countries agreed on the need for reform?

OECD countries recognize that fundamental reform is necessary if agricultural policies are to meet society's demands in the 21st century. In overall terms, reform has so far been modest. In 2003, the level of support provided to farmers (the Producer Support Estimate) was USD 257 billion, which represented 32% of total farm receipts in the OECD area, compared with an average of 37% between 1986 and 1988. Output-based support and input subsidies accounted for 75% of support to farmers in 2003, compared with 90% in 1986-88. Within these aggregates, there have been significant differences in the pace of reform between countries.

OECD countries have agreed on a Positive Reform Agenda for agricultural policies for the practical reason that fundamental reform would lead to policies that are more effective at meeting their stated objectives, and could do so without imposing a burden on other countries. Current policies, in contrast, are mostly ineffective in achieving their objectives, whether they pertain to the incomes of farm households or the level of public services.

With regard to farm incomes, there is no evidence that farm households have systematically lower incomes than other types of household in OECD countries, so policies to support incomes across the whole sector are not necessary. Yet approximately two-thirds of support is provided through sector-wide policies that support prices to all producers at higher levels than would otherwise prevail. Where income support for (some) farm households is an objective, it is important that it be pursued in an efficient and cost-effective way. Yet as Figure 1 shows, only about one-quarter of price support translates into additional income for farm households. This is because higher prices stimulate output, and hence input demand, with the result that much of the increase in receipts is paid back out to input suppliers or capitalised into land values. More generally, OECD analysis has found that the majority of support in OECD countries is provided through measures that are highly ineffective at translating support from consumers and taxpayers into additional income for farm households.

The most effective form of support is direct income payments that are "decoupled" from agricultural activity altogether, so that farm and non-farm households have the same criteria of eligibility. In practice, all payments that are contingent upon being a farmer will have some impact on output. But insofar as those payments eliminate the incentive for additional production, money does not "leak" to the owners of other resources (land, inputs) whose prices would be bid up with payments that were linked to agricultural activity in some way. A further benefit is that direct income payments can be targeted and delivered to those households that policymakers decide to be in need of assistance. OECD work has demonstrated that in most OECD countries this is likely to be a minority of all households in the farm sector. Thus another major saving comes from not spending money on policies that benefit households with already high incomes

Another justification provided for agricultural policies is that they provide public services, such as a pleasing countryside and contributions to biodiversity. However, it is difficult to assess the effectiveness of current policies in providing these public benefits, because the most important question is often not asked. Namely, in the absence of current policies which public benefits would be under-provided, and how much would it cost to deliver them via targeted policies?

In principle, it is better to pay directly for public goods and services, rather than to rely on current policies that cannot target specific outcomes. This is especially true when (as in the case of the environment) current agricultural policies do harm as well as good. In addition, since the cost of providing such a public good or service is likely to be lower with a targeted instrument, the optimal provision should be higher. In other words, if we can save money on policies designed to provide public benefits, we will choose more of them. Smaller agricultural enterprises may well be better at providing some of those benefits than largescale enterprises (for example a pleasing landscape), in which case targeted provision would also reduce the need for any explicit income support.

There are possible exceptions to this principle. If public goods and services are linked to the scale of agricultural production, and if there would be very high administrative costs associated with direct provision, then there could be conditions under which it would cost more to provide such benefits directly. The existence of such exceptions has so far neither been confirmed nor refuted.

Finally, and importantly, a large share of current support is provided through policies that necessitate the use of trade protection. This amplifies the net costs of inefficient domestic policies, and imposes a burden on other countries. It can also lead to a vicious cycle, whereby protectionist measures are defended on the basis that other countries are doing the same. Trade controversies can then spill over to other sectors, making multi-sector international trade agreements difficult to broker.

How are domestic reforms linked to trade liberalisation?

The adoption of targeted domestic policies that are "decoupled" from agricultural production eliminates the need for all trade protection other than science-based measures necessary to protect plant or animal health.

In contrast, market interventions, which dominate current policies, typically need trade policies to hold them in place. For example, a support measure that sustains the domestic price above the level at which a country can import requires an accompanying restriction on imports. Equivalently, stand-alone trade policies can provide the mechanism through which domestic support is maintained. When the extent of support becomes extreme, such that a country is transformed from a net importer to one with a disposable surplus, the use of export subsidies may also be required. In short, trade policies are often a by-product of domestic policies.

Moving from trade protection and output support to more decoupled and targeted measures would greatly reduce, but not completely eliminate, trade distortions. Agriculture-specific subsidies of any kind have an impact on trade, because they provide an incentive to produce and therefore influence the pattern of specialisation among countries. But the severity of these impacts depends very much on the policy instrument that is used. For example, open-ended price supports provide a direct stimulus to production (and choke off consumption), leading to a strong impact on trade. Area payments have a weaker production effect because they provide an incentive to bring additional land into production, but not necessarily to increase yield on that land. Direct income payments have a smaller impact still. Figure 2 shows how support in OECD countries remains centred around the kinds of measures that require trade policies to hold them in places.

Trade protection compounds the losses associated with inefficient domestic policies. In effect, countries forgo the benefits that derive from specialisation and trade according to their comparative advantage. From a national perspective, these gains exist even when other countries provide import protection or subsidise exports. It is true that farmers may face unfair competition in the absence of offsetting subsidies, but in overall terms these costs are likely to be outweighed by the gains to consumers. The global gains from agricultural trade liberalisation are estimated to be around USD 60 billion per year, with all OECD countries expected to benefit from both multilateral and unilateral liberalisation.

It is important to distinguish the collective and individual interest in open markets from the view of trade protection as a "bargaining chip" to be withheld pending liberalisation by other countries. It is equally important to recognise that the structural propensity for agricultural productivity increases to outpace demand growth means that there is adjustment pressure at the global level. Nearly all countries have an ever decreasing share of national resources, including labour, engaged in agriculture. Trade protection cannot make this global tendency disappear; it can only shift the burden of adjustment onto other countries.

Despite the prospect of aggregate gains, not everyone gains from liberalisation, at least in the short run. Some countries (notably some low income developing countries) may lose from agricultural trade liberalisation, including exporters with preferential trading arrangements who could see their preference margins eroded, and net food importers who could see their food import bills rise relative to what they would otherwise be. However, these countries can gain from a multi-sector agreement, and the challenge is to find ways of addressing their specific concerns in the context of a liberal trading environment (e.g through Special and Differential Treatment), rather than to use such effects as a reason not to reform. Within countries, there will inevitably be winners and losers, with those who formerly benefited from protection standing to lose. Again, the optimal approach is to address those issues directly, via policies that ease the transition into more productive (and ultimately remunerative) activities, rather than to eschew reform altogether.

From a political standpoint, trade reforms would put pressure on the most ineffective domestic policies. In particular, commitments to improve market access (notably via tariff cuts) and to eliminate export subsidisation would make price supports less tenable, and reinforce the shift to direct forms of support which are not linked to production and are less trade distorting. Equally, domestic reforms, by reducing the need for border measures, make it easier for reforming countries to reach agreement in a multilateral context.

What is the Positive Reform Agenda?

The Positive Reform Agenda sets out alternative agricultural policy options for OECD governments, which would enable them to achieve their stated objectives and at the same time avoid negative, unintended consequences at home and abroad. The fundamental tenets of this agenda are straightforward.

The first requirement is that governments need to be clear about what their objectives are. In particular, policy objectives need to be defined in a measurable way, such that the cost-effectiveness of alternative approaches can be compared. This would improve the transparency of policy-making and help overcome some of the political obstacles to reform.

The stated objectives of agricultural policies in OECD countries fall into two categories: those concerned with the incomes of farm households, and those designed to address other societal concerns such as the environment, the provision of rural amenities, land and water management, food safety and food security. In each case, government policies are introduced because of the belief that private markets alone may not lead to optimal outcomes.

The Positive Reform Agenda suggests that if policies in each of these areas are to be fully effective, they need to address their objectives directly. In the case of agricultural incomes, targeted direct income payments to households that are de-linked from production are much more effective at raising net incomes than sector-wide market interventions such as price support. Similarly, the wider costs and benefits of agricultural activity could be tackled more efficiently at source, for example by charging for social costs (such as pollution) and by paying for social benefits that the market alone may under-provide (such as a pleasing countryside).

Fundamental reform of agricultural policies in OECD countries has proved difficult to achieve, despite longstanding recognition of the potential benefits. A wider understanding of both the consequences of many existing policies and the availability of alternative approaches may help overcome some of the inertia. The Positive Reform Agenda highlights how domestic policy objectives can be met more effectively than at present, while at the same time avoiding negative impacts at home and abroad.

Such a re-focusing of policies would in turn enable a reduction in the overall level of support. Moving away from blunt instruments such as price supports to more targeted policies would not only be more effective, it would reduce the domestic burden on consumers and taxpayers, and enable harmful import barriers and export subsidies to be eliminated. Three examples demonstrate how these principles could begin to be put into practice.

Ensuring adequate **farm household income** from one year to the next is a longstanding policy objective in many OECD countries. Although there is no evidence of a widespread income problem in agriculture, some farm households in all OECD countries do have systemically low incomes. Effective policy responses would address the root causes of their low incomes. In some cases, policies to improve farm profitability might be needed, for example through initiatives to upgrade skills or adopt new technologies. In other cases, measures to improve off-farm income or create employment opportunities in other sectors might be more appropriate, for example via broader economic and rural development initiatives. In attempting to protect low income farm households, and provide them with better alternatives, the social policies available for low income households generally might be the most effective. Farm households also face risks that are beyond their control, such as exceptionally bad weather or some plant or animal diseases. Governments may wish to ensure that households have the tools they need to manage such risks effectively, by providing a viable environment for futures markets or whole farm income insurance schemes.

The well-being of **rural communities** is also a widely held policy objective. In general, across the OECD area, agriculture no longer constitutes a major element of economic activity in rural areas. There are exceptions, of course, and agriculture does remain an important source of employment and income in some regions. At the same time, it is clear that farm policy is not synonymous with rural policy, and that farm policy does not constitute effective rural policy. Effective policy actions would target the underlying causes of economic disadvantages in specific places and regions. In particular, there may be systemic policy bias against some rural and remote areas that could be eliminated. For example, physical infrastructure and essential public services might be more costly to establish and to maintain, resulting in underinvestment in some rural areas. This would exacerbate disadvantages relating to distance from populations and markets. Strategic investments in information technology could, for example, enable rural businesses to compete effectively from relatively remote areas. In some cases, initiatives to encourage entrepreneurship, small business start-up, and risk taking (for example, venture capital schemes or business training and advisory services) might be helpful. Overall, local multi-sector initiatives, rather than traditional farm commodity programmes, would be expected to perform more effectively in contributing to sustainable economic development in rural areas.

OECD countries seek to ensure **environmental sustainability**. But the majority of current support, being linked to output, provides farmers with incentives to increase the intensity of production and also to expand farm production on environmentally sensitive land. While more attention is now given to agri-environmental issues, notably in the form of regulation, less than 4% of total support provided by governments to agriculture is targeted to environmental objectives. Effective policy actions would pay directly for any positive impacts (such as the maintenance of biodiversity or the provision of a particular type of landscape), and tax or regulate negative ones. Both types of policy responses would be more effective if accompanied by the withdrawal of longstanding policies that encourage production of traditional commodities. It may also be appropriate to look for policy options outside the agricultural sector. Broader environmental policy might be further integrated with agriculture specific measures, with the aim of improving the performance of both sets of policies.

OECD consumers and taxpayers will gain considerably from implementing a Positive Reform Agenda. So too will competitive food and agriculture suppliers in both developed and developing countries. But not everyone will gain, and there will be some dislocation and adjustment. For reform to be sustainable, these adjustment challenges need to be recognised and addressed. In some cases, it will be possible for farm households to adapt and remain within the sector, in which case temporary measures may facilitate a change in farming practices or scale of operation. In other cases, transitional support to enable farm households to shift into more viable employment opportunities may be needed, for example through labour market policies. Finally, reform can be facilitated with the backing of economy-wide social programmes.

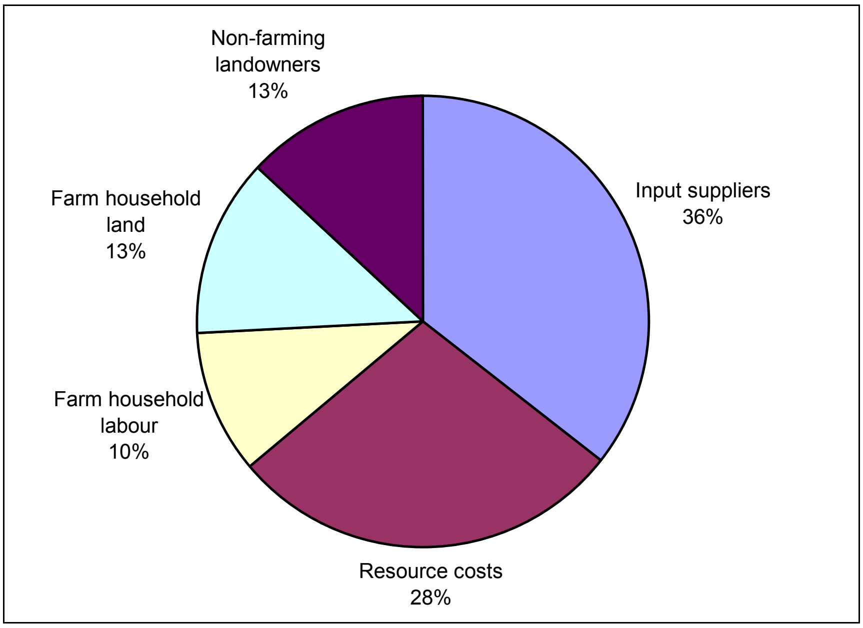
These examples of alternative policy approaches are illustrative, not prescriptive. The appropriate mix of policies will vary from one country to the next, and the process of reform will need to be managed carefully in each case. Reform can also be facilitated by explanation of the rationale for reform, by preparing people for its consequences, and by ensuring that agricultural reforms proceed consistently with reforms in other sectors. The overall direction that agricultural policy reforms should take is nevertheless clear, and the sooner those reforms are enacted, the sooner the benefits will be realised and the lower will be the associated costs.

Adapted and updated from a June 2003 OECD Policy Brief, ***Agricultural policies in OECD Countries: A Positive Reform Agenda***

For further reading

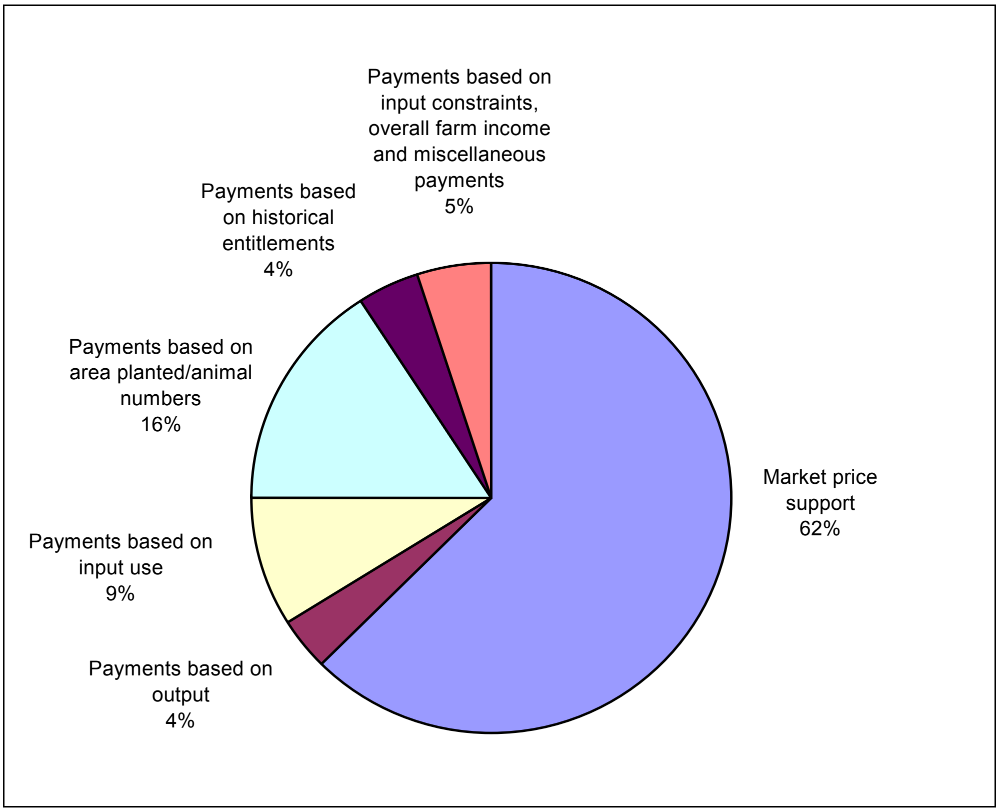
-**Agricultural Policies in OECD Countries: A Positive Reform Agenda**, 2002.
ISBN: 9264199675, 40p. Available at: *www.oecd.org/agr*
-**Farm Household Incomes: Issues and Policy Responses**, 2003.
ISBN: 9264099654, €21, 84p.
-**Agricultural Policies in OECD Countries: Monitoring and Evaluation**, 2003.
ISBN: 9264102299 €64, 260p.
-**OECD Agricultural Outlook, 2003-2008**, forthcoming.
-**Agricultural Trade and Poverty: Making Policy Analysis Count**, 2003.
ISBN: 9264174974, €36, 332p.
-**Multifunctionality: Towards an Analytical Framework**, 2001.
ISBN: 9264186255, €42, 160p.
-**Decoupling: A Conceptual Overview**, 2001.
Available at: *www.oecd.org/agr*
-**Market Effects of Crop Support Measures**, 2001.
ISBN: 9264195270, €30, 120p.
-**The Uruguay Round Agreement on Agriculture: An Evaluation of its Implementation in OECD Countries**, 2001.
ISBN: 9264186263, €46, 164p.
-**Improving the Environmental Performance of Agriculture: Policy Options and Market Approaches,** 2001.
Available at: *www.oecd.org/agr/env*

Figure 1. Where does the money go?
The income transfer efficiency of market price support.



Source: OECD (2003). Farm household incomes: issues and policy responses.

Figure 2. The composition of producer support in OECD countries, 2003



Source: OECD 2004. Agricultural policies in OECD countries: monitoring and evaluation